PREFATORY NOTE

These transcripts have been produced from the original raw transcripts in the FOMC Secretariat's files. The Secretariat has lightly edited the originals to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcripts were not fully edited for accuracy at the time they were produced because they were intended only as an aid to the Secretariat in preparing the records of the Committee's policy actions. The edited transcripts have not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Federal Open Market Committee

Conference Call

September 24, 1982

PRESENT: Mr. Volcker, Chairman
Mr. Solomon, Vice Chairman
Mr. Black
Mr. Ford
Mr. Gramley
Mrs. Horn
Mr. Martin
Mr. Partee (New York)
Mr. Rice
Mrs. Teeters

Messrs. Guffey, Keehn, Morris, and Roos
Alternate Members of the Federal Open Market Committee

Messrs. Boehne, Boykin, and Corrigan, Presidents of the Federal Reserve Banks of Philadelphia, Dallas, and Minneapolis, respectively

Mr. Williams, First Vice President, Federal Reserve Bank of San Francisco

Staff attendance at this meeting was not recorded in the Committee's files.

Transcript of Federal Open Market Committee Conference Call of September 24, 1982

[Secretary's note: This call began with reports by staff on recent economic and financial developments. These reports were not transcribed.]

CHAIRMAN VOLCKER. Well, you have had a description, on the technical side so to speak, of the money situation, the market situation, the government securities market, and the general stability elsewhere I suppose it's fair to say. In terms of the general background, my own conclusion--and anybody can comment on this a little later--is that it is clear that any sense of economic expansion has been delayed. Immediate signs of economic expansion, apart from as a matter of faith, are sorely lacking. Investment is declining and is going to decline for some time. The atmosphere, if anything, seems to be weakening, and survey data seem to show a weakening. Consumption is rather flat; there is no sparkle to it and that's the [sector] we have to look to for expansion. It is a situation with some risks, looked at it just in terms of the internal economy.

As I look at what is going on abroad: The problems of Mexico have in no way cleared up; the problems of the rest of Latin America are clearly being compounded by a general economic slowdown and recession; there are very few signs of life in Europe; and there's a weakening, if anything, in Japan from an already not very strong situation. One gets the same sense [abroad as here] of where the risks and concerns seem predominantly to be at this particular stage in development.

I think we have a pretty good record on the inflation side and, on balance I suppose, things seem to be getting more entrenched there. The weaknesses in the financial system remain very evident both internationally and domestically although I sense--and Peter might want to comment on this--that there's a little less feeling of people being right on the edge of their chairs in the financial markets this week [than there was] maybe two weeks ago. But they are not very far back from being on the edge of their chairs. There is still a lot of differentiation in markets; there is still a relatively calm and easy situation in the central money market, which has a sense of calming things, but a very uncertain, nervous atmosphere is continuing.

To get to the point, in the end, I think this is a situation in which I would not find a mechanical application of the reserve provision rules suitable, given the certainty that that would lead to a decided change on the tightening side from recent money market conditions. In terms of what seems desirable, that runs against any other broader background that we see going on. I feel that at least for this brief period before we actually meet in a Federal Open Market Committee meeting, which is about a week and a half off, or seven working days off, we should not follow--and I would not intend to--a mechanical application of those reserve provisions but rather stabilize market conditions somewhere close to where they are presently or even slightly below where they have been in the last couple of weeks.

MR. ROOS. Where are the [money growth] figures coming in, Mr. Chairman? Do you know what today's report will show?

CHAIRMAN VOLCKER. Minus $1.3 billion on M1, unless that has changed.

MR. AXILROD. No, [it has not changed].

CHAIRMAN VOLCKER. But the report will show an upward revision for last week, and that upward revision is related to the quarterly reporters. Whether it reflects reality or not, I don't know, but we have what--a $600 million revision?

MR. AXILROD. $700 million.

CHAIRMAN VOLCKER. A $700 million upward revision.

MR. GRAMLEY. What will that number be for the [week ending September] 8th?

MR. AXILROD. The revised number for the 8th will be $461.9 billion. Then there will be a $1.3 billion drop from there, which is well within the range of market expectations. That's about what they are expecting--I mean the drop, not the upward revision.

MS. TEETERS. What is your number for the 22nd? Is it up?

MR. AXILROD. Well, it's very uncertain, but it might be somewhat above the level of the 8th.

MR. GRAMLEY. Have you figured out what the third quarter will be relative to the second?

MR. AXILROD. Yes, assuming the growth that we now have, Q3 over Q2 would be 3.8 percent.

MR. FORD. Paul, this is Bill Ford. What exactly does the policy change you are proposing for the next few days mean? Do you want to cap interest rates at 10-1/4 percent? What are you proposing?

CHAIRMAN VOLCKER. I would not call it a policy change. I would say the operational variable would essentially be borrowings of around $500 to $600 million.

MR. FORD. Up from $300 to $350 million, right?

CHAIRMAN VOLCKER. It was $350 million when the period started but it actually has been higher than that. We are in a situation where it has been very difficult to judge the impact of the borrowings, particularly because of the two special situations. The level of borrowings that we have depends upon what weight we give those. But it's clearly higher than it was when we started the period, though much more moderate than it would be if we literally followed the path.

MR. FORD. In other words, we are just moving the path up by a couple of hundred million.

CHAIRMAN VOLCKER. We are moving the nonborrowed path up, yes. That's correct.

MR. FORD. But you are not saying that we are capping the funds rate at 10-1/4 percent?

CHAIRMAN VOLCKER. No, I'm not saying that, but [the higher path] obviously will have some impact in that connection. I am saying--let me not [unintelligible] anybody--that I think it would be a misguided policy to follow a direction right now that is likely to create a pronounced increase in interest rates.

MR. MORRIS. Paul, this is Frank Morris. I think you're exactly right.

MR. BOEHNE. This is Ed Boehne. As far as the general background on the economy, I think you summarized the situation quite well. There is just no evidence that I can see that a recovery is in sight, and now and then I run into people who think that the downturn may not be over. However you slice it, there is a great deal of weakness in the economy. And on that basis, I think your prescription for policy for right now makes a lot of sense. So, I will be 100 percent [with you] on that.

CHAIRMAN VOLCKER. Let me just throw in a quasi-fact with respect to the outlook. The Rinfret survey, which is the first survey of plant and equipment spending that comes along--I don't know what reliability our experts would put on it--shows steeper declines this year and next year than anything that has come out so far.

MR. ROOS. Are you suggesting, Paul, essentially that we hold the line until we get together at the next FOMC meeting?

CHAIRMAN VOLCKER. Yes. I don't think there's any point to discuss beyond that. That is specifically what I am saying. I don't think we should let the mechanics drive us before we meet next, a week from Tuesday.

MS. HORN. Paul, may I just clarify what you were saying about the borrowing number? Could you just repeat the number or the range you were giving and state whether the $150 million of special borrowing is included in that amount?

CHAIRMAN VOLCKER. I left myself a little range to cover that possibility; I don't think I want to be that mechanical, Karen. I said $500 to $600 million roughly, including it. But if special borrowing jumped up--if Continental Illinois, say, came in and borrowed $2 billion tomorrow--I'm not implying that we would [unintelligible] to offset that. We'd let that go and print a much higher borrowing figure.

MS. HORN. Okay. But generally what you're saying is that we are lowering the borrowing number from where it is and--

CHAIRMAN VOLCKER. I said raise. I suppose the technical way to put it a little more clearly is that we would raise the nonborrowed path by a few hundred million from where it would be. And the calculation would be in line with what we think would be, by accident or otherwise, somewhat consistent with the current amount of pressure on the money market.

MS. HORN. Your feeling is that if we were to stay with the nonborrowed path, that would perhaps drive fed funds rates up toward 11 percent or above?

CHAIRMAN VOLCKER. Well, I wouldn't put that fine a measure on it. There is no doubt that if we followed the path absolutely literally and didn't use any judgment, it would drive the funds rate decidedly higher. With what lag I don't know, because it may take some time for the market to realize it. More important than precisely where the funds rate is, I think it could well lead to an impression in the market for the moment that the whole trend of interest rates would be reversed. I just could not predict what impact that would have on long-term rates and the whole structure of rates generally or what impact that would have on something like the bank CD rate, which clearly is affected now, and could be affected a lot more, by simple nervousness about banks. And the difficulty banks with any kind of special unfortunate relationship with the markets feel [would be] even stronger. We have had enough indications recently of a tendency [for investors] to walk away from CDs. In fact, we now see that, I might mention, in the aggregate banking data. We see it in two ways: in an aggregate decline in CDs, which could be related to other factors but is suspiciously correlated with the market developments; and we see it particularly in the troubled banks. The three or four banks that tend to get mentioned have a rather noticeable decline in their CD takings.

MR. ROOS. When would the first weekly figures be published that would show a significant increase in M1 growth according to Steve's projections?

CHAIRMAN VOLCKER. In a sense they already do because the big increase came in the first week [of the month] and we are not expecting any increases beyond that. But they are not coming down enough to give us a low figure. We had some increases at the end of August and we had that big increase in the first week in July. And despite some subsequent declines, that gives us a big September.

MR. ROOS. I see.

CHAIRMAN VOLCKER. The current trend is not [unintelligible] is a message that the System is [now] trying to get out [assuming] we aren't going to be mechanical about business. And it's very helpful. It would seem to me that it would also be helpful if in the coming days the message could also get out that there may be some special factors at work here, and in fact that strengthens the case for why we're not adding a mechanical response. I think that could be a positive message to get out.

MR. BLACK. Mr. Chairman, Bob Black. It seems to me that we have real problems in interpreting these borrowed reserve figures because we don't know what part is interest sensitive and what part isn't. It's a task, really, to know how the federal funds rate [might move] more than anything else. If I interpret what you're saying correctly, you would anticipate that this lowering of the borrowed reserve target a little would lead to a decline in the federal funds rate.

CHAIRMAN VOLCKER. No, I don't think that's necessarily true. The federal funds rate has been as high as 10-1/2 percent; more recently, it has been as low as a little under 10 percent. All I would say is that I think it probably would be comfortably within that range. If you look at it at least over a period of time, I don't think I'm talking about any distinct difference in the federal funds rate. At least I would not expect that.

MR. BLACK. Would you anticipate that the actual level of borrowing would decline somewhat from where it is now?

CHAIRMAN VOLCKER. Well, where [is it]? I don't know.

MR. AXILROD. We're going to publish today a level of borrowing for the week of the 22nd of $691 million.

SPEAKER(?). Right.

MR. AXILROD. [That includes] special borrowing by a large bank in the week of the 15th--not special borrowing, but borrowing that occurred at 12 or 13 percent. So, it probably would be close to or below the [recent] level.

CHAIRMAN VOLCKER. Yes, in the absence of--

MR. AXILROD. --any special borrowing.

CHAIRMAN VOLCKER. If we had the special or quasi-special deals waltzing in here, with big amounts of borrowing, it would be high. And that, of course, was particularly prominent in that one week when it was over $1 billion.

SPEAKER(?). That's right.

CHAIRMAN VOLCKER. If that happened again, we could get a bigger borrowing figure. But I'm talking about what we would aim for. If those come in, we wouldn't offset them unless we thought there were some particular reason to.

MR. BLACK. Yes, I can't see any great [need to change] the borrowed reserve target even though we are running pretty strong. But I'm not sure it's wise to lower it a bit at this junction. It looks to me as if it's moving in the wrong direction, really.

MS. HORN. Yes, I share Bob's view on that. It seems to me, if it is a [unintelligible] to raise it for a number of reasons that haven't been discussed here, that unless we see it as something very negative on the side of causing more volatility in interest rates, [we should leave it]. I would tend to leave it where it is myself.

CHAIRMAN VOLCKER. Oh, now you're talking about risks. Let me leave no doubt. I see it as extremely negative in terms of actually precipitating a change in the interest rate quiescence that we have at the moment. Precisely what level of borrowings produces that I do not know. But I'm quite confident about what direction the risks lie in.

MR. BLACK. [There is a risk in moving it] to any extent from where it is now, with the aggregates running so strongly. If we hold it, I think the market will understand that there probably are reasons for not raising it; but if we let if drop, I believe we might get some negative reactions in the long-term bond market.

CHAIRMAN VOLCKER. Drop it from where? The last figures the market has were $1.1 billion or something and $700 million. If those figures persist, we'll get a rise in the federal funds rate and other interest rates if there is no special-situation borrowing.

MR. BLACK. Well, I was thinking about excluding the special borrowings. That was my thought; the interest-sensitive part was the one that I was not sure we should hold.

CHAIRMAN VOLCKER. I'm saying we exclude that. And if we end up at $700 million to $1.1 billion of borrowings, we're going to run a substantial risk of precisely the type I don't think should be run.

MR. BLACK. I wouldn't suggest raising it; I was just saying I'm not sure we ought to lower it. It's [unintelligible] this week, if I'm correct on my figures. And if we came down to $500 or $600 million, it would be lower than that. I was saying further that I don't think these figures mean as much now because of the uncertainty about what part is interest sensitive and what part isn't. And maybe this is the time really to look at the federal funds rate. The bottom line of what I was saying was that I don't think it would be too wise to let that drift down from where it is, in view of the strength in the aggregates.

CHAIRMAN VOLCKER. You may not then achieve your objective on the federal funds rate.

MR. GRAMLEY. Well, I think we could take into account Bob's comment about the greater uncertainty with respect to any numbers about borrowing by giving you a wider range, Mr. Chairman--giving you a $500 to $700 million range and letting you use that judiciously. My own hunch is that the kinds of reactions in financial markets we are likely to get, depending on which way we go, are the reverse of those that Bob Black is worried about. My perception is that Wall Street now has a view that interest rates simply can't go up because the economy is sick, sick, sick. So, if we started any operation that began to push interest rates up by reacting strongly to an overrun on M1 now, that would be the worst possible thing we could do.

MR. BLACK. I agree with that, Lyle. I was just saying that I don't think we ought to take any action that forces the federal funds rate down at this point. That was the only point I was making when I got down to the bottom line.

CHAIRMAN VOLCKER. We're not talking about that.

VICE CHAIRMAN SOLOMON. It may be of interest to you that I have had it said to me that people are hoping there will be a bank failure because then monetary policy [will operate in such a way that] they know that rates will come down further.

CHAIRMAN VOLCKER. Well, the more cosmic issues we can discuss a week from Tuesday. Unless somebody wants to say something more, I think I have a sense of the general thrust of things.

MR. GUFFEY. Paul, Roger Guffey.

CHAIRMAN VOLCKER. Yes, sir.

MR. GUFFEY. My question to you is whether or not this should be a formal vote for the purpose of directly telling the staff to adjust the nonborrowed path, so that when the figures are published in the future the regime that we're allegedly on will be clearly understood by the markets. We looked at it; we saw great growth and we were willing to accommodate it because there were all sorts of reasons why we put our faith on accommodating it. I'd prefer to see us actually act on your recommendation.

CHAIRMAN VOLCKER. Well, my sense is--and I recognize your point--that that is a little difficult to do without lending more confusion. Let me think about it a little more. We don't have to do it today; if we want to come back and do it next week, we can do it. When I went back and looked at the directive from the previous meeting, what we are talking about seemed to me to be amply covered. And the facts will speak for themselves. We have a sentence almost directly to this point in the directive.

MR. GUFFEY. [Unintelligible] what range of the federal funds rate you can use under that directive. I have read that we are indeed moving to an interest rate target, which I might say I think is appropriate for a time. But for the record, I'm inclined to think we would achieve less confusion if we had a formal vote. I don't think you'll have a problem getting [a majority].

MR. MARTIN. Roger, I think what will happen ex post, when the market players review what we have done and the rationale, is that inevitably they will read between the lines and add all kinds of nonfunctional reasons for what we did in addition to our own reasons. I'd lean against a vote.

CHAIRMAN VOLCKER. I will tell you, when I first thought about this, Roger, that the idea of having a special decision published--and it would be published only two weeks from today--as to why we had to meet specially and change the directive roughly one week before the next Committee meeting lent a tone to it that I didn't think would be helpful.

MR. MARTIN. There would be all kinds of fears advanced in the cottage industry of the Fed watchers.

SPEAKER(?). Yes.

SPEAKER(?). It occurs to me that it might be very supportive, for instance, of the Fed's credibility in the sense of our recognizing what is happening in the economy.

CHAIRMAN VOLCKER. Well, I don't think we can write it today, anyway. Let me think about it. I really do not think it is technically necessary, given the way the directive is written. Let me turn it over in my mind again over the weekend as to whether there are positive advantages in it. Any other comments? If not, thank you.

MR. ROOS and others. Thank you.

END OF SESSION